

AMENDED IN SENATE APRIL 1, 2008

**SENATE BILL**

**No. 1421**

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**Introduced by Senator Harman**

February 21, 2008

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An act to amend Sections 15408, ~~16052~~, 16336.4, 16370, and 16371 of the Probate Code, relating to trusts.

LEGISLATIVE COUNSEL'S DIGEST

SB 1421, as amended, Harman. Trust administration: income and principal.

Existing law regulates the administration of trusts by trustees on behalf of beneficiaries. Existing law provides that, if the principal of a trust does not exceed \$20,000 in value, the trustee has the power to terminate the trust.

This bill would provide, instead, that a trustee has the power to terminate a trust if the principal does not exceed ~~\$100,000~~ \$40,000 in value.

~~Existing law provides that, unless otherwise provided in the trust instrument, a power vested in 2 or more trustees may be exercised only by their unanimous action. Existing law allows a trustee to delegate investment and management functions as prudent under the circumstances.~~

~~This bill would allow a trustee to delegate investment and management functions to one or more cotrustees of the trust.~~

The Uniform Principal and Income Act requires a trustee to make specified disbursements from income and principal.

This bill would allow a trustee, if he or she is unable to charge certain disbursements to income because of insufficient income, to charge any deficiency in those disbursements to principal. It would also allow a

trustee, if he or she is unable to charge certain disbursements to principal because of insufficient cash and readily marketable assets, to charge any deficiency in those disbursements to income. The bill would provide that a charge against income or principal under these provisions shall not entitle the income of the trust to any subsequent reimbursement from principal, nor the principal to any subsequent reimbursement from income.

Vote: majority. Appropriation: no. Fiscal committee: no.  
State-mandated local program: no.

*The people of the State of California do enact as follows:*

1 SECTION 1. Section 15408 of the Probate Code is amended  
2 to read:  
3 15408. (a) On petition by a trustee or beneficiary, if the court  
4 determines that the fair market value of the principal of a trust has  
5 become so low in relation to the cost of administration that  
6 continuation of the trust under its existing terms will defeat or  
7 substantially impair the accomplishment of its purposes, the court  
8 may, in its discretion and in a manner that conforms as nearly as  
9 possible to the intention of the settlor, order any of the following:  
10 (1) Termination of the trust.  
11 (2) Modification of the trust.  
12 (3) Appointment of a new trustee.  
13 (b) Notwithstanding subdivision (a), if the trust principal does  
14 not exceed ~~one hundred forty thousand dollars~~ ~~(\$100,000)~~  
15 ~~(\$40,000)~~ in value, the trustee has the power to terminate the trust.  
16 (c) The existence of a trust provision restraining transfer of the  
17 beneficiary's interest does not prevent application of this section.  
18 ~~SEC. 2. Section 16052 of the Probate Code is amended to read:~~  
19 ~~16052. (a) Notwithstanding Section 15620, a trustee may~~  
20 ~~delegate investment and management functions as prudent under~~  
21 ~~the circumstances to one or more persons, including one or more~~  
22 ~~cotrustees of the trust. The trustee shall exercise prudence in the~~  
23 ~~following:~~  
24 ~~(1) Selecting the delegate or delegates.~~  
25 ~~(2) Establishing the scope and terms of the delegation, consistent~~  
26 ~~with the purposes and terms of the trust.~~

1 ~~(3) Periodically reviewing the overall performance of the~~  
2 ~~delegate or delegates and compliance with the terms of the~~  
3 ~~delegation.~~

4 (b) In performing a delegated function, a delegate has a duty to  
5 exercise reasonable care to comply with the terms of the delegation.

6 ~~(e) Except as otherwise provided in Section 16401 or, in the~~  
7 ~~case of a cotrustee who is a delegate, Section 16402, a trustee who~~  
8 ~~complies with the requirements of subdivision (a) is not liable to~~  
9 ~~the beneficiaries or to the trust for the decisions or actions of the~~  
10 ~~delegate to whom the function was delegated.~~

11 ~~(d) By accepting the delegation of a trust function from the~~  
12 ~~trustee of a trust that is subject to the law of this state, a delegate~~  
13 ~~submits to the jurisdiction of the courts of this state.~~

14 ~~SEC. 3.~~

15 SEC. 2. Section 16336.4 of the Probate Code is amended to  
16 read:

17 16336.4. (a) Unless expressly prohibited by the governing  
18 instrument, a trustee may convert a trust into a unitrust, as  
19 described in this section. A trust that limits the power of the trustee  
20 to make an adjustment between principal and income or modify  
21 the trust does not affect the application of this section unless it is  
22 clear from the governing instrument that it is intended to deny the  
23 trustee the power to convert into a unitrust.

24 (b) The trustee may convert a trust into a unitrust without a court  
25 order if all of the following apply:

26 (1) The conditions set forth in subdivision (a) of Section 16336  
27 are satisfied.

28 (2) The unitrust proposed by the trustee conforms to the  
29 provisions of paragraphs (1) to (8), inclusive, of subdivision (e).

30 (3) The trustee gives written notice of the trustee's intention to  
31 convert the trust into a unitrust and furnishes the information  
32 required by subdivision (c). The notice shall comply with the  
33 requirements of Chapter 5 (commencing with Section 16500),  
34 including notice to a beneficiary who is a minor and to the minor's  
35 guardian, if any.

36 (4) No beneficiary objects to the proposed action in a writing  
37 delivered to the trustee within the period prescribed by subdivision  
38 (d) of Section 16502 or a longer period as is specified in the notice  
39 described in subdivision (c).

(c) The notice described in paragraph (3) of subdivision (b) shall include a copy of Sections 16336.4 to 16336.7, inclusive, and all of the following additional information:

(1) A statement that the trust shall be administered in accordance with the provisions of subdivision (e) and the effective date of the conversion.

(2) A description of the method to be used for determining the fair market value of trust assets.

(3) The amount actually distributed to the income beneficiary during the previous accounting year of the trust.

(4) The amount that would have been distributed to the income beneficiary during the previous accounting year of the trust had the trustee's proposed changes been in effect during that entire year.

(5) The discretionary decisions the trustee proposes to make as of the conversion date pursuant to subdivision (f).

(d) In deciding whether to exercise the power conferred by this section, a trustee may consider, among other things, the factors set forth in subdivision (g) of Section 16336.

(e) Except to the extent that the court orders otherwise or the parties agree otherwise pursuant to Section 16336.5 after a trust is converted to a unitrust, all of the following shall apply:

(1) The trustee shall make regular distributions in accordance with the governing instrument construed in accordance with the provisions of this section.

(2) The term "income" in the governing instrument shall mean an annual distribution, the unitrust amount, equal to 4 percent, which is the payout percentage, of the net fair market value of the trust's assets, whether those assets would be considered income or principal under other provisions of this chapter, averaged over the lesser of the following:

(A) The three preceding years.

(B) The period during which the trust has been in existence.

(3) During each accounting year of the trust following its conversion into a unitrust, the trustee shall, as early in the year as is practicable, furnish each income beneficiary with a statement describing the computation of the unitrust amount for that accounting year.

(4) The trustee shall determine the net fair market value of each asset held in the trust no less often than annually. However, the

1 following property shall not be included in determining the unitrust  
2 amount:

3 (A) Any residential property or any tangible personal property  
4 that, as of the first business day of the current accounting year,  
5 one or more current beneficiaries of the trust have or have had the  
6 right to occupy, or have or have had the right to possess or control,  
7 other than in his or her capacity as trustee of the trust, which  
8 property shall be administered according to other provisions of  
9 this chapter as though no conversion to a unitrust had occurred.

10 (B) Any asset specifically devised to a beneficiary to the extent  
11 necessary, in the trustee's reasonable judgment, to avoid a material  
12 risk of exhausting other trust assets prior to termination of the trust.  
13 All net income generated by a specifically devised asset excluded  
14 from the unitrust computation pursuant to this subdivision shall  
15 be accumulated or distributed by the trustee according to the rules  
16 otherwise applicable to that net income pursuant to other provisions  
17 of this chapter.

18 (C) Any asset while held in a testator's estate or a terminating  
19 trust.

20 (5) The unitrust amount, as otherwise computed pursuant to this  
21 subdivision, shall be reduced proportionately for any material  
22 distribution made to accomplish a partial termination of the trust  
23 required by the governing instrument or made as a result of the  
24 exercise of a power of appointment or withdrawal, other than  
25 distributions of the unitrust amount, and shall be increased  
26 proportionately for the receipt of any material addition to the trust,  
27 other than a receipt that represents a return on investment, during  
28 the period considered in paragraph (2) in computing the unitrust  
29 amount. For the purpose of this paragraph, a distribution or an  
30 addition shall be "material" if the net value of the distribution or  
31 addition, when combined with all prior distributions made or  
32 additions received during the same accounting year, exceeds 10  
33 percent of the value of the assets used to compute the unitrust  
34 amount as of the most recent prior valuation date. The trustee may,  
35 in the reasonable exercise of his or her discretion, adjust the unitrust  
36 amount pursuant to this subdivision even if the distributions or  
37 additions are not sufficient to meet the definition of materiality set  
38 forth in the preceding sentence.

1 (6) In the case of a short year in which a beneficiary's right to  
2 payments commences or ceases, the trustee shall prorate the  
3 unitrust amount on a daily basis.

4 (7) Unless otherwise provided by the governing instrument or  
5 determined by the trustee, the unitrust amount shall be considered  
6 paid in the following order from the following sources:

7 (A) From the net taxable income other than capital gains,  
8 determined as if the trust were other than a unitrust.

9 (B) From net realized short-term capital gains.

10 (C) From net realized long-term capital gains.

11 (D) From tax-exempt and other income.

12 (E) From principal of the trust.

13 (8) Expenses that would be deducted from income if the trust  
14 were not a unitrust may not be deducted from the unitrust amount.

15 (f) The trustee shall determine, in the trustee's discretion, all of  
16 the following matters relating to administration of a unitrust created  
17 pursuant to this section:

18 (1) The effective date of a conversion to a unitrust.

19 (2) The frequency of payments in satisfaction of the unitrust  
20 amount.

21 (3) Whether to value the trust's assets annually or more  
22 frequently.

23 (4) What valuation dates to use.

24 (5) How to value nonliquid assets.

25 (6) The characterization of the unitrust payout for income tax  
26 reporting purposes. However, the trustee's characterization shall  
27 be consistent.

28 (7) Any other matters that the trustee deems appropriate for the  
29 proper functioning of the unitrust.

30 (g) A conversion into a unitrust does not affect a provision in  
31 the governing instrument directing or authorizing the trustee to  
32 distribute principal or authorizing the exercise of a power of  
33 appointment over or withdrawal of all or a portion of the principal.

34 (h) A trustee may not convert a trust into a unitrust in any of  
35 the following circumstances:

36 (1) If payment of the unitrust amount would change the amount  
37 payable to a beneficiary as a fixed annuity or a fixed fraction of  
38 the value of the trust assets.

39 (2) If the unitrust distribution would be made from any amount  
40 that is permanently set aside for charitable purposes under the

governing instrument and for which a federal estate or gift tax deduction has been taken, unless both income and principal are set aside.

(3) If possessing or exercising the power to convert would cause an individual to be treated as the owner of all or part of the trust for federal income tax purposes, and the individual would not be treated as the owner if the trustee did not possess the power to convert.

(4) If possessing or exercising the power to convert would cause all or part of the trust assets to be subject to federal estate or gift tax with respect to an individual, and the assets would not be subject to federal estate or gift tax with respect to the individual if the trustee did not possess the power to convert.

(5) If the conversion would result in the disallowance of a federal estate tax or gift tax marital deduction that would be allowed if the trustee did not have the power to convert.

(i) If paragraph (3) or (4) of subdivision (h) applies to a trustee and there is more than one trustee, a cotrustee to whom the provision does not apply may convert the trust unless the exercise of the power by the remaining trustee or trustees is prohibited by the governing instrument. If paragraph (3) or (4) of subdivision (h) applies to all of the trustees, the court may order the conversion as provided in subdivision (b) of Section 16336.5.

(j) (1) A trustee may release the power conferred by this section to convert to a unitrust if either of the following circumstances exist:

(A) The trustee is uncertain about whether possessing or exercising the power will cause a result described in paragraph (3), (4), or (5) of subdivision (h).

(B) The trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in subdivision (h).

(2) A release pursuant to paragraph (1) may be permanent or for a specified period, including a period measured by the life of an individual.

~~SEC. 4.~~

*SEC. 3.* Section 16370 of the Probate Code is amended to read:

16370. (a) A trustee shall make the following disbursements from income to the extent that they are not disbursements to which paragraph (2) or (3) of subdivision (c) of Section 16340 applies:

1 (1) Except as otherwise ordered by the court, one-half of the  
2 regular compensation of the trustee and of any person providing  
3 investment advisory or custodial services to the trustee.

4 (2) Except as otherwise ordered by the court, one-half of all  
5 expenses for accountings, judicial proceedings, or other matters  
6 that involve both the income and remainder interests.

7 (3) All of the other ordinary expenses incurred in connection  
8 with the administration, management, or preservation of trust  
9 property and the distribution of income, including interest, ordinary  
10 repairs, regularly recurring taxes assessed against principal, and  
11 expenses of a proceeding or other matter that concerns primarily  
12 the income interest.

13 (4) All recurring premiums on insurance covering the loss of a  
14 principal asset or the loss of income from, or use of, the asset.

15 (b) If the trustee is unable to charge disbursements governed  
16 by this chapter to income because of insufficient income, the trustee  
17 may charge any deficiency in those disbursements to principal. A  
18 charge against principal under this subdivision shall not entitle the  
19 principal of the trust to any subsequent reimbursement from  
20 income.

21 ~~SEC. 5.~~

22 *SEC. 4.* Section 16371 of the Probate Code is amended to read:

23 16371. (a) A trustee shall make the following disbursements  
24 from principal:

25 (1) Except as otherwise ordered by the court, the remaining  
26 one-half of the disbursements described in subdivisions (a) and  
27 (b) of Section 16370.

28 (2) Except as otherwise ordered by the court, all of the trustee's  
29 compensation calculated on principal as a fee for acceptance,  
30 distribution, or termination, and disbursements made to prepare  
31 property for sale.

32 (3) Payments on the principal of a trust debt.

33 (4) Expenses of a proceeding that concerns primarily principal,  
34 including a proceeding to construe the trust or to protect the trust  
35 or its property.

36 (5) Premiums paid on a policy of insurance not described in  
37 subdivision (d) of Section 16370 of which the trust is the owner  
38 and beneficiary.

39 (6) Estate, inheritance, and other transfer taxes, including  
40 penalties, apportioned to the trust.



1 (7) Disbursements related to environmental matters, including  
2 reclamation, assessing environmental conditions, remedying and  
3 removing environmental contamination, monitoring remedial  
4 activities and the release of substances, preventing future releases  
5 of substances, collecting amounts from persons liable or potentially  
6 liable for the costs of those activities, penalties imposed under  
7 environmental laws or regulations and other payments made to  
8 comply with those laws or regulations, statutory or common law  
9 claims by third parties, and defending claims based on  
10 environmental matters.

11 (b) If a principal asset is encumbered with an obligation that  
12 requires income from that asset to be paid directly to the creditor,  
13 the trustee shall transfer from principal to income an amount equal  
14 to the income paid to the creditor in reduction of the principal  
15 balance of the obligation.

16 (c) If the trustee is unable to charge disbursements governed by  
17 this chapter to principal because of insufficient cash and readily  
18 marketable assets, the trustee may charge any deficiency in those  
19 disbursements to income. A charge against income under this  
20 subdivision shall not entitle the income of the trust to any  
21 subsequent reimbursement from principal.